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GLOBAL TURNAROUND

The international magazine for company rescue and insolvency specialists

January 2021 | issue 252

ISSN 1743-1751

New Year, New Europe

In a dramatic development reflecting the rapidly changing landscape in the European cross-border restructuring market, a US investor has challenged an English Scheme by filing for a Dutch Scheme.

In The Netherlands the new Dutch 'WHOA' scheme legislation enacted four weeks ago has already attracted four filings which have been recognised by the courts. Dutch lawyers say 'a tsunami of fillings' under WHOA is to follow.

Meanwhile the French say they will introduce their own restructuring initiative 'by the end of May' (see Page 3).

And while London's position as an international cross-border restructuring hub may be under attack, it had one reason for celebration this month; the first-ever use of the cross-class cram-down contained in the UK's new Restructuring Plan legislation launched last year (see page 7).

In contrast, the market in Germany is eerily quiet, with no reported filings yet under the much-lauded StaRUG restructuring framework, also launched on 1 January.

Testing the new law requires restructuring cases. One obstacle is the very low level of insolvencies in Germany at the moment, (see pages 4-5). One German insolvency lawyer lamented: "Where are all the cases?"

The German StaRUG also suffered from last-minute changes, due to powerful lobbying by the German car manufacturing companies, the OEMs. The OEMs were worried that powers within StaRUG to modify or reject contracts could be used as a negotiating weapon by auto

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Germany's new StaRUG is good - but slightly less good, due to last minute changes

It is striking how Europe's insolvency and restructuring innovations are aimed at taking English prototypes as a role model and improving them even as the UK exits the EU, potentially taking the London market's role as an unchallenged global restructuring centre with it.

The most obvious prototype is the English law Scheme of Arrangement, a piece of Companies Act legislation which the courts in the UK have had over a hundred years to hone and perfect. A highly flexible tool which attracted corporate users as far and wide as Russia and Vietnam, but which could prove expensive – or lucrative, depending on your point of view.

The EU passed its Preventive Restructuring Directive specifically to enable companies to restructure at an early stage outside of formal insolvency proceedings. The idea was for each country to transpose into local legislation a restructuring procedure at least as good as, and if possible better than, the English Scheme.

But instead of introducing one EU-wide Scheme, taking into account the many particularities of the various national insolvency regimes, the EU opted to require all 27 member states to introduce their own out-of-court restructuring mechanisms, to be enacted in local law by July 2021.

The option was also added that countries could ask for a year's extension to implement the EU scheme. It looks like over half the 27 member states will do just that, mostly from Central and Eastern Europe (CEE).

The Netherlands and Germany both launched their respective responses to the EU Directive on 1 January.

Complicated titles

The new German legislation contains a complicated series of titles. The German 'scheme' is titled 'Framework for the Stabilisation and Restructuring of Companies', or 'StaRUG' for short.

It contains as its centerpiece a restructuring mechanism called a stabilisation and restructuring framework, or 'SRF'.

The StaRUG is embedded in an overall package of laws called 'SanInsFoG', which also amends provisions of the German insolvency law and many other laws.

'An important step'

Heiko Tschauner, a restructuring partner at Hogan Lovells in Munich, says: "This is an important step to make the German restructuring landscape internationally competitive.

"The new law's centerpiece will be the so-called stabilisation and restructuring framework, or SRF, which enables you to restructure a company with a 75 per cent majority vote of the respective creditor groups," said Tschauner.

The new law can be used only if the company is facing impending illiquidity, and therefore before it has any obligation to initiate formal insolvency proceedings.

Heiko Tschauner, Hogan Lovells

According to Tschauner, German legislators made two important changes to the StaRUG before enacting it, which potentially lessens its impact.

Termination of contracts

Under the original draft the debtor company could apply to the restructuring court to terminate mutual contracts, as long as the contracts had not been fully performed by both parties, and as long as the contracting party had not complied with the debtor's request for a modification or termination of that contract.

However, the German Federal Council (Bundesrat) objected to this regulation, and all corresponding rules to this have been deleted in the new law.

Mutual (partly) unperformed contracts may therefore not be terminated without the contractual party's consent, except for in insolvency proceedings.

Some observers suggested that Germany's powerful real estate lobby had succeeded in changing the legislation where its restructuring practitioner lobby had failed.

Competition with the Dutch

Tschauner said: "My understanding is that the Dutch Scheme goes beyond the German Scheme insofar as it allows the debtor to propose its counterparties to amend a contract as it deems fit.

"If such a proposal is not accepted by the counterparty, the debtor can, with approval of the court, terminate the contract, taking into account a notice period effective as per the date the Scheme is sanctioned by the court," said Tschauner.

"Further, the Dutch Scheme will only be recognised in other EU member states under the European Insolvency Regulation if, firstly, the procedure is public and second, the debtor's centre of main interests (COMI) is in the Netherlands.

"I do not expect that there will be many COMI shifts of German companies to the Netherlands just to make use of the contract termination possibility," Tschauner said. "I think if a debtor needs this option in Germany it is easier to initiate a regular insolvency plan proceeding which gives the option to terminate contracts."

'Zone of insolvency'

The German proposals also contained new directors' duties in cases where the company is facing illiquidity, in other words where it is 'entering the zone of insolvency'.

The question of exactly when and how the chief responsibility of directors of distressed companies should shift from shareholders to creditors has always been a vexed question in insolvency law, German or otherwise.

Germany's draft law initially envisaged that in cases of pending illiquidity the management of the company should (primarily) be obliged to preserve the interests of the company's creditors.

"These draft regulations, which had been debated quite controversially, have been rejected as well," said Tschauner.

Under the new law the management is obliged only to conduct the restructuring with the 'diligence of a prudent business manager' and insofar to preserve the creditors' interests.

Despite some last minute changes in order to find an acceptable compromise between diametrically opposing interest groups and making the new law more digestible , the final version of the new law also provides for an important improvement compared to the former draft, said Tschauner.

The possibilities to impair security granted by other companies of the group have been expanded. In future it will not only be possible to impair upstream securities, but also security which have been provided by affiliated companies. Tschauner concluded:

> "This is an important tool which will facilitate restructurings of companies in complex group structures."

As far as the restructuring plan of the debtor company applies to the claims of all creditors, the restructuring court may under certain preconditions install a creditors council. Such a council would supervise and support the debtor company's management.

Tschauner added:

"The use of the new law will require some preparation time for troubled companies, so that we will likely see the first cases towards the end of the first quarter of 2021."